Supreme Court, U.S.
FILED
JAN 13 2003
OFFICE OF THE CLERK

No. 02-903

IN THE

Supreme Court of the United States

FRANK GRYL and BARBARA GRYL,
f/b/o SHIRE PHARMACEUTICALS GROUP PLC,

Petitioners,

v.

SHIRE PHARMACEUTICALS GROUP PLC,
ZOLA HOROVITZ, RONALD NORDMANN,
and JOHN SPITZNAGEL,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION FOR RESPONDENTS ZOLA HOROVITZ, RONALD NORDMANN, AND JOHN SPITZNAGEL

THOMAS A. ARENA
Counsel of Record
JEFFREY L. NAGEL
JOHN A. BOYLE
MILBANK, TWEED, HADLEY
& MCCLOY LLP
1 Chase Manhattan Plaza
New York, NY 10005-1413
(212) 530-5000

Attorneys for Respondents Zola Horovitz, Ronald Nordmann, and John Spitznagel

178396

COUNSEL PRESS
(800) 274-3321 • (800) 359-6859

COUNTER-STATEMENT OF THE QUESTION PRESENTED

Whether the United States Court of Appeals for the Second Circuit correctly affirmed the dismissal of Petitioners' claim brought pursuant to Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b).

STATEMENT PURSUANT TO RULE 29.6

Petitioners, alleged stockholders of nominal defendant Shire Pharmaceuticals Group, PLC ("Shire"), have sued on behalf of Shire. Respondents Zola Horovitz, Ronald Nordmann, and John Spitznagel are individuals.

TABLE OF CONTENTS

	Page
Counter-Statement of the Question Presented	i
Statement Pursuant to Rule 29.6	ii
Table of Contents	iii
Table of Cited Authorities	v
Statutes and Regulations Involved	1
Counter-Statement of the Case	3
Reasons for Denying the Writ	6
I. The Shire Options Granted To Respondents Were Exempt From Section 16(b) Because The Issuer's Board Of Directors Approved The Transaction Pursuant To Rule 16b-3(d)(1)	6
A. The Plain Language Of Rule 16b-3(d)(1) Supports Dismissal Of This Case	6
B. The Second Circuit's Decision Is Consistent With Note 3 To Rule 16b-3(d)(1)	7

Contents

Page

II. The Second Circuit's Decision Is Consistent With The Policies Underlying Section 16(b) 10

A. Section 16(b) Is A Strict Liability Provision And Must Be Construed Narrowly 10

B. The Second Circuit's Decision Does Not Weaken The Intended Effect Of Section 16(b) 12

Conclusion 13

TABLE OF CITED AUTHORITIES

Page

Cases:

Gollust v. Mendell,
501 U.S. 115 (1991) 10

Reliance Electric Co. v. Emerson Electric Co.,
404 U.S. 418 (1972) 10

Statutes:

15 U.S.C. § 78p(b) ..... i, 1, 4, 10

Rules:

17 C.F.R. § 240.16b-3 ..... *passim*

17 C.F.R. § 240.3a12-3 6

17 C.F.R. § 240.3b-4 6

Other Authorities:

Ownership Reports & Trading By Officers, Directors & Principal Sec. Holders, Exchange Act Release No. 34-37260, 61 Fed. Reg. 30,376 (June 14, 1996) 8, 11

SEC Letter, *American Society of Corporate Secretaries* (December 11, 1996) 9

STATUTES AND REGULATIONS INVOLVED

Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b), provides in pertinent part:

> For the purpose of preventing the unfair use of information which may have been obtained by . . . [a] director . . . by reason of his relationship to the issuer, any profit realized by him from any purchase and sale . . . of any equity security of such issuer . . . within any period of less than six months . . . shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such . . . director . . . in entering into such transaction. . . . Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction . . . by the owner of any security of the issuer in the name and in behalf of the issuer. . . .

Rule 16b-3(d)(1), 17 C.F.R. § 240.16b-3(d)(1), promulgated by the Securities and Exchange Commission, provides in pertinent part:

> (a) *General.* A transaction between the issuer (including an employee benefit plan sponsored by the issuer) and an officer or director of the issuer that involves issuer equity securities shall be exempt from section 16(b) of the Act if the transaction satisfies the applicable conditions set forth in this section.
>
> * * *

(d) *Grants, awards and other acquisitions from the issuer.* Any transaction involving a grant, award or other acquisition from the issuer (other than a Discretionary Transaction) shall be exempt if:

(1) The transaction is approved by the board of directors of the issuer, or a committee of the board of directors that is composed solely of two or more Non-Employee Directors. . . .

Note 3 to Rule 16b-3(d) provides in pertinent part:

> The approval conditions of paragraph[] (d)(1) . . . of this section require the approval of each specific transaction, and are not satisfied by the approval of a plan in its entirety except for the approval of a plan pursuant to which the terms and conditions of each transaction are fixed in advance, such as a formula plan. Where the terms of a subsequent transaction (such as the exercise price of an option, or the provision of an exercise or tax withholding right) are provided for in a transaction as initially approved pursuant to paragraph[] (d)(1) . . . such subsequent transaction shall not require further specific approval.

COUNTER-STATEMENT OF THE CASE

Respondents are three former directors of Roberts Pharmaceutical Corporation ("Roberts"). Respondents became directors of Shire following the merger of a Shire subsidiary into Roberts on December 23, 1999 (the "Merger"). The Agreement and Plan of Merger among Shire and Roberts (the "Merger Agreement") provided that at the Effective Time of the Merger, each issued and outstanding option to acquire Roberts common stock ("Roberts Options") — including those held by Respondents — would be assumed by Shire and automatically converted into options to acquire Shire common stock ("Shire Options"). (Pet. App. at 6a).[1]

The Merger Agreement fixed in advance all pertinent terms and conditions of the conversion of Roberts Options into Shire Options. The Merger Agreement set forth a defined exchange ratio (the "Exchange Ratio") pursuant to which the stock option conversion would be made. The Merger Agreement further specified that the exercise price for each Shire Option would equal the fixed exercise price per share of each Roberts Option, divided by the Exchange Ratio. (*Id.* at 13a-14a; 34a). Finally, the Merger Agreement included a detailed Disclosure Schedule that set forth the exact number of Roberts Options held by each optionholder, as well as the date upon which each option had been granted, the expiration date, and the exercise price. (*Id.* at 34a).

Because the Merger Agreement set forth in detail the fixed terms of the Shire Options grant, the only question for the Second Circuit to resolve was whether, in approving the

1. Citations to "Pet. App." are to the Petitioners' Appendix submitted with the Petition For A Writ Of Certiorari.

Merger Agreement, the Shire Board also approved the conversion of Roberts Options into Shire Options in accordance with Rule 16b-3(d)(1). The Second Circuit correctly answered this question in the affirmative.

Based on a plain reading of the text of Rule 16b-3(d)(1), the Second Circuit noted that the rule does not require that the issuer's board of directors approve each individual transaction separately. The Second Circuit correctly held that the Rule 16b-3(d)(1) exemption applied to the board approval of a "plan of which the subject transactions are but a constituent part, so long as the plan approved is one 'pursuant to which the terms and conditions of each transaction are fixed in advance, such as a formula plan.'" (*Id.* at 11a) (quoting Rule 16b-3(d), Note 3). As the Second Circuit concluded, the Merger Agreement "left Roberts option holders no discretion unilaterally to alter in their favor the amount, price, timing and exercise terms of the impending option conversion. Far from being open-ended, the Merger Agreement precisely delimited the securities grants that the individual defendants would ultimately receive on the effective date of the Merger." (*Id.* at 14a-15a).

The Second Circuit rejected the two arguments advanced by Petitioners challenging whether the Shire Board's approval of the Merger Agreement sufficed to exempt the conversion of Roberts Options into Shire Options from Section 16(b). The Court of Appeals dismissed Petitioners' contention that because the July 22, 1999 board approval was "conditioned on final approval of the Merger Agreement by a committee of the board as well as final approval of the Merger by Shire shareholders," the Shire Board's approval did not constitute Rule 16b-3(d)(1) "approval" of the Shire Options grant. (*Id.* at 17a). Adopting the views expressed by the SEC in its

amicus brief, the Second Circuit held that the board approval exemption of Rule 16b-3(d)(1) "does not require that board approval be the definitive event in the grant of securities to an officer or director." (*Id.* at 18a). The court held that the mere existence of other conditions to the Merger, such as stockholder approval, was "irrelevant" for purposes of the Rule 16b-3(d) exemption so long as the issuer's board had approved the transaction. (*Id.*).

The Second Circuit also declined to adopt Petitioners' argument that the board approval exemption required the Shire Board to make an express indication that it was approving the option conversion for the purpose of obtaining an exemption under Rule 16b-3(d). The Court again relied upon the SEC's views in its *amicus* brief, in which the SEC "counsel[ed] against reading a purpose-specific approval requirement into Rule 16b-3(d)(1)." (*Id.* at 18a-19a, citing SEC *amicus* brief). The Second Circuit found "wholly unpersuasive the artificial imposition of purpose-specific approval" on the board approval exemption advocated by Petitioners. (*Id.* at 19a). Again turning to the plain language of Rule 16b-3(d), the Second Circuit noted that nothing in the text of the rule required purpose-specific approval. The Court further observed that no court to have considered the issue required that the issuer's board expressly state its subjective intent in order to exempt the transaction from Section 16(b). (*Id.* at 21a).

In short, this is a straight-forward case.[2] The Second Circuit's reasoning is uncontroverted by any other federal court decision and is fully supported by the SEC's interpretation of its own rule as set forth in the *amicus* brief filed by the SEC in this case. Apparently not content with the views of the district court, the Second Circuit or the SEC, Petitioners now seek a writ of certiorari from this Court. The Petition should be denied.

REASONS FOR DENYING THE WRIT

I. The Shire Options Granted To Respondents Were Exempt From Section 16(b) Because The Issuer's Board Of Directors Approved The Transaction Pursuant To Rule 16b-3(d)(1)

A. The Plain Language Of Rule 16b-3(d)(1) Supports Dismissal Of This Case

Rule 16b-3(d) provides that any issuer-to-insider transaction involving a grant of issuer equity securities shall be exempt from Section 16(b) if the transaction is approved "by the board of directors of the issuer." Rule 16b-3(d)(1); 17 C.F.R. § 240.16b-3. Note 3 to Rule 16b-3(d) clarifies that, to obtain

2. The district court also correctly dismissed this action on three other independent legal grounds: (1) that Respondents became Shire directors only after the Merger became effective, and therefore were not statutory insiders subject to Section 16(b) liability at the time of the options grant; (2) that Shire maintained its Foreign Private Issuer status under Rule 3b-4, 17 C.F.R. § 240.3b-4, at the time of the Shire Options grant, thereby exempting the Shire options grant from Section 16(b) pursuant to the exemption contained in Rule 3a12-3, 17 C.F.R. § 240.3a12-3; and (3) that the Shire Board, in approving the Merger Agreement, had approved "each specific transaction" by which Respondents received their Shire Options in light of the inclusion of the Disclosure Schedule in the Merger Agreement, referenced above. (Pet. App. at 27a-33a). The Second Circuit "express[ed] no opinion" with respect to these alternative grounds of dismissal. (*Id.* at 8a).

the benefit of the exemption, the issuer's board does not need to approve each individual transaction, but may approve "the overall plan" so long as the plan approved is one "pursuant to which the terms and conditions of each transaction are fixed in advance, such as a formula plan." *See* 17 C.F.R. § 240.16b-3, Note 3.

The Shire Board's approval of the Merger Agreement sufficed to exempt from Section 16(b) the conversion of Roberts Options into Shire Options. The Merger Agreement set forth specific terms pursuant to which all Roberts optionholders, including Respondents, would receive their grant of Shire Options. (Pet. App. at 13a-14a; 34a). The Merger Agreement fixed in advance the amount, price, timing and exercise terms of the option conversion. Here, because the Shire Board's approval of the Merger Agreement encompassed the approval of the Shire Options grant pursuant to a plan, the terms and conditions of which were fixed in advance in accordance with Rule 16b-3(d), the transactions were exempt from Section 16(b). (*Id.* at 11a).

B. The Second Circuit's Decision Is Consistent With Note 3 To Rule 16b-3(d)(1)

Petitioners incorrectly suggest that the Shire Board's approval of the Merger Agreement did not satisfy the requirements of Note 3. Specifically, Petitioners assert that the Merger Agreement's "one-shot grant" of Shire Options did not constitute a "formula plan" within the meaning of Note 3, as that term has been interpreted in various SEC Staff no-action letters. (Pet. App. at 5-11).

Petitioners' argument is based on a flawed reading of Note 3. Nothing in Note 3 limits the board approval exemption of Rule 16b-3(d)(1) to employee benefit plans

that are ongoing in nature. Nor did the 1996 SEC Release accompanying the promulgation of the rule impose any such limitation on the board approval exemption. The 1996 SEC Release, which was cited by the Second Circuit in its opinion below, broadly defined the term "formula plan" to include the "grant or award of securities 'made pursuant to a plan that by its terms . . . sets forth a formula that determines the amount, price and timing, using objective criteria.'" (*Id.* at 12a) (citing Ownership Reports & Trading by Officers, Dirs. & Principal Sec. Holders, Exchange Act Release No. 34-37260, 61 Fed. Reg. 30,376, at 30,381 n.71 (June 14, 1996)). That is precisely what the Merger Agreement did in this case with respect to the Shire Options. The Merger Agreement set forth the "amount, price and timing" of the Shire Options grant, "using objective criteria."

Notwithstanding the Second Circuit's compliance with the plain language of Rule 16b-3(d), Petitioners contend that the Second Circuit extended the exemptive rule beyond its intended scope and did not give sufficient deference to language in the 1996 SEC Release that a "plan that constitutes a 'formula plan' under staff interpretations of current Rule 16b-3(c)(2)(ii) will be considered a formula plan" for purpose of Rule 16b-3(d). (*Id.* at 5). But this language from the 1996 SEC release is of no help to Petitioners. The 1996 SEC release does *not* state that the "formula plans" discussed in previous "staff interpretations" were the *only kinds of transactions* that would constitute "formula plans" under Rule 16b-3(d). The language used by the SEC was *inclusive*. It explained that "formula plans" previously approved in SEC no-action letters would still constitute "formula plans" under Rule 16b-3(d). Thus, the prior SEC "staff interpretations" that Petitioners now argue were "incorporated by reference," (*Id.* at 5, 7), into the 1996 SEC release did not restrict the

Second Circuit from concluding that additional types of transaction arrangements, such as those present in this case, also meet the requirements of a "formula plan" under Rule 16b-3(d).

Moreover, even ~~if~~, *arguendo*, the Merger Agreement itself does not constitute a "formula plan," Note 3 does not limit the board approval exemption for multiple securities transactions solely to "formula plans." Rather, Note 3 requires only that the "terms and conditions of each transaction" be "fixed in advance, such as a formula plan." The phrase "*such as* a formula plan" (emphasis added) included at the end of Note 3 is descriptive. It indicates that "formula plans" are but *one example* of the kind of transactions in which the "terms and conditions" are "fixed in advance."

In this case, the rationale for allowing a group of transactions to be approved by a board in their "entirety" as part of a merger agreement, and not on a transaction-by-transaction basis, was manifest: where the terms and conditions of the Shire Options were fixed and unalterable, where those terms were set forth in detail in the Merger Agreement, and where that Merger Agreement was approved by the Shire Board, there was no risk of insider manipulation by the option grantee. *See, e.g.*, *American Society of Corporate Secretaries* (December 11, 1996) (Q.8) (SEC staff letter indicating that a one-time board approval of a plan allowing directors to elect to receive options in lieu of cash fees met Rule 16b-3(d) exemption where the plan specified a formula for determining the amount of options to be paid).

To be sure, as the Second Circuit held, "whether the formulae set forth in a given plan are adequately specific turns on the overall corporate context served by the plan's

grant or award of securities." (Pet. App. at 12a). Examining the "overall corporate context" in this case, the Second Circuit reasonably concluded that the formulae set forth in the Merger Agreement met the conditions and served the purposes of the Rule 16b-3(d)(1) exemption. There is no basis to overturn that legal determination, and Petitioners provide none.

II. The Second Circuit's Decision Is Consistent With The Policies Underlying Section 16(b)

A. Section 16(b) Is A Strict Liability Provision And Must Be Construed Narrowly

Section 16(b) was designed to prevent corporate insiders from realizing profits based on the "unfair use of information" obtained "by reason of [their] relationship to the issuer." *See* 15 U.S.C. § 78p(b). Because Section 16(b) can subject presumptive insiders to liability regardless of their intent or their actual access to inside information, this Court has held that the statute should be construed narrowly. *See Gollust v. Mendell*, 501 U.S. 115, 122 (1991) (explaining that the statute should not be applied in a "mechanical" fashion but, instead, courts should look to the "evil that Congress sought to correct through §16(b)") (quoting *Reliance Electric Co. v. Emerson Electric Co.*, 404 U.S. 418, 423 (1972)).

In 1996 when the SEC enacted Rule 16b-3(d)(1) to provide certain broad exemptions to Section 16(b) transactions, the SEC specifically noted that transactions between issuers and their directors and officers generally "are not vehicles for the speculative abuse that Section 16(b) was designed to prevent." Ownership Reports & Trading By

Officers, Directors & Principal Sec. Holders, Exchange Act Release No. 34-37260, 61 Fed. Reg. 30,376, 30,377 (June 14, 1996). The SEC singled out transactions such as the ones at issue here as beyond the intended scope of Section 16(b): "Typically, where the issuer, rather than the trading markets, is on the other side of an officer's or director's transaction in the issuer's equity securities, any profit obtained is not at the expense of uninformed shareholders and other market participants of the type contemplated by the statute." *Id.*

In this case, Petitioners seek to predicate Section 16(b) liability on the basis of transactions between an issuer and directors that involve nothing more than the automatic conversion of stock options pursuant to a merger. This is an unprecedented attempt to stretch Section 16(b) liability beyond its intended scope. The exemptions set forth in Rule 16b-3, including the advance board approval exemption contained in Rule 16b-3(d)(1), must be interpreted in light of the intended purpose and effect of Section 16(b) and the SEC's promulgation of the Rule 16b-3(d)(1) exemption.

Here, the Shire Board unequivocally approved the conversion of Roberts Options into Shire Options. Petitioners do not suggest that any holders of Roberts Option, including Respondents, misused inside information when they acquired their Shire Options pursuant to the Merger. Given that the subject transactions do not implicate the type of market manipulation that Section 16(b) was designed to prevent, there is no basis to reject the Second Circuit's entirely plausible interpretation of the exemptive rule. As the Second Circuit explained,

> [s]o long as the relevant securities transaction is between an issuer and insider, and so long as the terms and conditions of that transaction receive advance approval by the board of directors, there exists sufficient protection to ensure that any short-swing profit taking that follows is not the result of unfair market manipulation.

Pet. App. at 21a.

B. The Second Circuit's Decision Does Not Weaken The Intended Effect Of Section 16(b)

Petitioners wrongly suggest that the Second Circuit's decision in this case "dismantled" the regulatory framework created by the SEC with respect to Rule 16b-3(d)(1), "annulled" the function of Section 16(b), and "remove[d] the [SEC] from the regulation and exemption of short-swing trading through the acquisition by insiders of securities in mergers or corporate combinations." (*Id.* at 12-14). Such hyperbole is completely misplaced.

In concluding that the Shire Options grant was exempt from Section 16(b), the Second Circuit solicited and gave proper deference to the SEC's *amicus* brief filed in this case. The Second Circuit's decision accords with the purposes of Section 16(b) as well as the SEC's interpretation of the regulatory regime. In the event that the SEC disagrees with the Second Circuit's interpretation of Rule 16b-3(d), the SEC can resolve any such conflict through appropriate agency rule-making. Petitioners do not supply any reason why this Court needs to undertake an analysis of the scope of the Rule 16b-3(d) exemption, given the SEC's ample ability to address any perceived problems in the regulatory framework.

CONCLUSION

For the foregoing reasons, Respondents Zola Horovitz, Ronald Nordmann and John Spitznagel respectfully request that the petition for writ of certiorari be denied.

Respectfully submitted,

THOMAS A. ARENA
Counsel of Record
JEFFREY L. NAGEL
JOHN A. BOYLE
MILBANK, TWEED, HADLEY
& MCCLOY LLP
1 Chase Manhattan Plaza
New York, NY 10005-1413
(212) 530-5000

Attorneys for Respondents
Zola Horovitz, Ronald Nordmann,
and John Spitznagel